2018

A Case by Case Study on Accounting Principles

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A CASE BY CASE STUDY ON ACCOUNTING PRINCIPLES

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A thesis submitted to the faculty of The University of Mississippi in partial fulfillment of the requirements of the Sally McDonnell Barksdale Honors College.

Oxford
May 2018

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This thesis is dedicated to all of the people who made my time at Ole Miss truly unforgettable.

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Abstract

This thesis contains twelve different case studies that regard some of accounting's key principles. Each case is different in its own right and contains vital applications that relate to real world scenarios. From analysis of business activities to computation of inventory, each case presents the opportunity to learn how real world scenarios are approached and executed. Over an eight-month period, each case was prepared through analysis and other means. Each case presents its own outcome and findings due to the fact that each case is unique. With the compilation of all twelve cases, this thesis presents a brief glimpse of how to understand the broad overview of accounting.

Case 1: Inventories

1. Inventories
    a. Raw materials inventory includes direct materials, indirect materials, and factory supplies.
    b. Work in Process inventory includes direct labor, indirect labor, and factory overhead.
    c. Finished goods inventory includes direct materials, direct labor, and factory overhead.
2. Net of Allowance for Obsolete or Unmarketable inventory, net
3. Inventory
    a. The account appears in current assets but it is a contra inventory account.
    b. 2011: 233,070+10,800=243,870   2012: 211,734+12520+224,254
    c. Raw materials are not obsolete. Work in Process is semi obsolete. Finished Goods are the most obsolete.
4. Journal Entries
    a. Debit: Cost of Sales 13,000
    b. Credit: Allowance for obsolete or unmarketable inventory 13000
    c. Debit: Allowance for obsolete or unmarketable inventory 11000
    d. Credit: Finished Goods Inventory 11000

5. T Accounts

Raw Materials	
$46,976	
438561	
	$442,068
$43,469	

Work in Process	
$1,286	
$126,000	
$442,064	
	$568,735
$619	

Finished Goods	
$184,808	
	$13,348
$568,735	$572,549
$167,646	

Cost of Sales	
$13,348	
$572,549	
$585,897	

Accounts Payable	
	$39,012
	$438,561
$432,197	
	$45,376

a. Cost of Goods Sold: 572,549

b. Cost of Goods Manufactured: 568,735

c. Cost of RM transferred to WIP: 442,068

d. Cost of Raw Materials Purchased: 438,561

e. Cash Disbursed for Raw Material Purchases: 20,216

6. Inventory Turnover Ratio

a. Cost of Sales/Average Inventories, net

i. 2012: 585,897/222,402= 2.63

ii. 2011: 575,226/250,830.5=2.29

7. Inventory Holding Period

a. 365/Inventory Turnover Ratio

i. 2012: 365/2.63= 138.78

ii. 2011: 365/2.29= 146.29

8. Percent of Obsolete Inventory

a. Obsolete Inventory/Finished Goods Inventory

i. 13348/180812= 7.38%

b. As a potential investor, the inclusion of a debt-to-equity ratio, asset turnover ratio, and a working capital ratio. Using these ratios would better help determine the solvency, liquidity, and financial flexibility.

Case 2: World Com, Inc.

A).

I). Assets are elements of a company that are like to provide future revenue or benefit to the company.

II). Expenses are anything that is used or done in the normal operations of the company. Cash is used to pay for these expenses.

B).

Net income – Capitalizing costs and depreciating them will show a better representation of the incomes that have been reported. A company that capitalizes costs will have a higher profitability than it would have had if it expensed them. Years later, the company that expensed the costs will most likely have a higher profitability than it would have had if it capitalized them.

Stockholders' equity - Over a period of time, expensing a cost or capitalizing it will have little effect on a shareholders' total equity. However, expensing firms will have a lower stockholders' equity to begin with.

Assets reported on the balance sheet - A company that capitalizes its costs will display higher total assets.

C). Line Costs (exp) 14,739,000,000

Cash 14,739,000,000

D) The costs capitalized were "charges paid to local telephone networks to complete calls."

Expense transaction gave rise to these costs.

These costs do not meet the definition. These line costs should not have been expensed.

E) PPE (Asset) 3,055,000,000

Line Costs (Exp) 3,055,000,000

Balance sheet: these cost were in the PPE

State of Cash Flows: Line Costs appear the depreciation/amortization

F) (771/22) *(4/4)=35.0455

(610/22)*(3/4)=20.7954

(743/22)*(2/4)= 16.8863636

(931/22)*(1/4)=10.5795454

TOTAL: 83,306,820

Depreciation Expense 83,306,820

Accum Dep 83,306,820

G). Income before taxes, as reported: 2,393,000,000

+Deprecation	83,306,820
-Line costs	3,055,000,000
Loss before taxes, restated:	-578693180
Income Tax Benefit	202542613
Minority Interest	35000000
Net loss Restated	-341,150,567

Case 3: Targa Co.

On December 27th, 20X1, Targa Co. relayed a message to their employees stating that the company would be ceasing production and closing the facility associated to the research and development of the line of Armor Track. In their one-time termination benefit plan, Targa Co. made a few errors in the way this process should be handled.

To disclose the information in the financial statements, Targa Co. should include the following according to the FASB Codification section 420-10-50-1:

> "a. A description of the exit or disposal activity, including the facts and circumstances leading to the expected activity and the expected completion date
>
> b. For each major type of cost associated with the activity (for example, one-time employee termination benefits, contract termination costs, and other associated costs), both of the following shall be disclosed:
>
> 1. The total amount expected to be incurred in connection with the activity, the amount incurred in the period, and the cumulative amount incurred to date
>
> 2. A reconciliation of the beginning and ending liability balances showing separately the changes during the period attributable to costs incurred and charged to expense, costs paid or otherwise settled, and any adjustments to the liability with an explanation of the reason(s) why.

c. The line item(s) in the income statement or the statement of activities in which the costs in (b) are aggregated

d. For each reportable segment, as defined in Subtopic 280-10, the total amount of costs expected to be incurred in connection with the activity, the amount incurred in the period, and the cumulative amount incurred to date, net of any adjustments to the liability with an explanation of the reason(s) why

e. If a liability for a cost associated with the activity is not recognized because fair value cannot be reasonably estimated, that fact and the reasons why."

According to 720-45-55 of the FASB codification, training expenses of a business reengineering plan will be recorded as an expense.

The plan that Targa Co. is providing to those employees that stay until the cease operations date is a one-time employee termination benefit. In section 420-10-25-4 of the codification, the follow is stated:

"An arrangement for one-time employee termination benefits exists at the date the plan of termination meets all of the following criteria and has been communicated to employees:

a. Management, having the authority to approve the action, commits to a plan of termination.

b. The plan identifies the number of employees to be terminated, their job classifications or functions and their locations, and the expected completion date.

c. The plan establishes the terms of the benefit arrangement, including the benefits that employees will receive upon termination (including but not limited to cash payments), in sufficient detail to enable employees to determine the type and amount of benefits they will receive if they are involuntarily terminated.

d. Actions required to complete the plan indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn."

An error made by Targa Co. is the late notice to the employees of the closing of the company. According to the FASB codification section 420-10-25-7:

"The minimum retention period shall not exceed the legal notification period, or in the absence of a legal notification requirement, 60 days. For example, in the United States, the Worker Adjustment and Retraining Notification Act, as of 2002 required entities with 100 or more employees to notify employees 60 days in advance of covered plant closings and mass layoffs, unless otherwise specified. Collective bargaining or other labor contracts may require different notification periods."

The appropriate date that the company should have notified the employees at minimum was December 3, 20X1.

Other associated costs with exits or disposals include relocation costs of employees according to 420-10-2514. Also, “the liability shall not be recognized before it is incurred, even if the costs are incremental to other operating costs and will be incurred as a direct result of a plan. A liability for other costs associated with an exit or disposal activity shall be recognized in the period in which the liability is incurred (generally, when goods or services associated with the activity are received).”

In following these guidelines set forth by FASB, Targa Co. will present and disclose its information correctly and effectively. The exit and/ or disposal of a company can be a difficult and draw out process for the financial side of the business. It would be in the best interest of the company to gain more knowledge of this process using the FASB codification.

Case 4: Equity

1) How many common shares has Merck actually issued at December 31, 2007?

   a. They have issued 2,983,508,675 shares in 2007.

2) Reconcile the number of shares issued at December 31, 2007, to the dollar value of common stock reported on the balance sheet.

   a. 2983508675x.01= 28,835,086.75

3) How many common shares are held in treasury at December 31, 2007?

   a. 811,005,791 treasury stock

4) How many common shares are outstanding at December 31, 2007?

   a. 5.4 billion-28,835,086.75= 2,416,491,325 common stock outstanding

5) At December 31,2007, Merck's stock price closed at $57.61 per share. Calculate the total market capitalization of Merck on that day.

   a. $416,491,325x57.61=$139,214,065,233 market capitalization

C) Why do companies pay dividends on their common or ordinary shares? What normally happens to a company's share price when dividends are paid?

a. Companies pay out dividends to stockholders because they own a percentage of the company; therefore, they are paid a percentage of the company's profit each year. If a company is paying out dividends, they are usually profitable and they may have stalled in growth. Company's share price goes down because the company is distributing its assets.

D) In general, why do companies repurchase their own shares?

a. Companies can repurchase shares to gain more control over their company with voting rights.

E) Consider Merck's statement of cash flow and statement of retained earnings. Prepare a single journal entry that summarizes Merck's common dividend activity for 2007.

Dr: Re 39,140,800,000

Cr: Div Pay 3,400,000

Cr:Cash 39,137,400,000

F) During 2007, Merck repurchased a number of its own common shares on the open market.

1) Describe the method Merck uses to account for its treasury stock transactions.

a. They use the cost method because it is the most common one

2) refer to note 11 to Merck's financial statements. How many shares did Merck repurchase on the open market during 2007?

a. They repurchased 26.5 million.

3) How much did Merck pay, in total and per share on average, to buy back its stock during 2007? What type of cash flow does this represent?

a.Total: 1,429,700,000

b.Per share: 53.95

C.financing cash flow: 43,300,343

4) Why doesn't Merck disclose its treasury stock as an asset?

a.Treasury stock is a contra equity account; therefore, it cannot be an asset.

G. Determine the missing amounts and calculate the ratios in the tables below. For comparability, use dividends paid for both companies rather than dividends declared. Use the number of shares outstanding at year end for per-share calculations. What differences do you observe in Merck's dividend-related ratios across the two years?

a. Merck's dividend ratios remain the same except dividend yield and payout.

(in millions)	2007	2006
Dividends Paid	3,307.3 billion	3,322.6
Shares Outstanding	2,416.4 billion	2,423.77
Net Income	3,275.4	4,433.8
Total Assets	48,350.7	44,569.8
Operating Cash Flows	6,999.2	6,765.2
Year-end stock price	$57.61	41.94
Dividend per share	1.37	1.37
Dividend yield	2,416.49	2,422.78
Dividend Payout	1.01	.75
Dividends to total assets	.07	.07
Dividends to operating cash flows	.47	.49

Case 5: Xilinix Inc

a. One of Xilinx's equity incentive plans is its employee stock option plan discussed in Notes 2 and 6. Explain, in your own words, how this plan works. What incentives do stock option plans such as this one provide to employees?

These options are made available out of right, not obligation, for the future issuance of common shares to employees and directors. There are also 16 million shares revers for future grants under the 2007 Equity Incentive Plan. There is a seven-year term from the date that the stock is granted. If the stock options were granted before April 1, 2007 then the stock usually expires within ten years of the grant date; however, stock granted to existing and newly hired employees vest over a four-year period from the grant date. These types of plans incentivize employees to stay for a certain amount of time at the company instead of wasting the companies time on the employees that will leave within the vesting period.

b. Xilinx also discusses the use of restricted stock units, also called RSUs (on page 63 of Xilinx's annual report). RSUs are grants valued in terms of Xilinx stock, but Xilinx does not issue the stock at the time of the grant. Upon satisfying the vesting requirements, Xilinx distributes to employees either shares or the cash equivalent of the number of shares used to value the unit. Compare the use of RSUs and stock options as a form of incentive compensation to employees. Why might companies offer both types of programs to employees?

Stock options could be fickle in the long run; however, they could result in huge pay outs to the holders. RSU’s are fixed and guarantee the holder’s the price that is stated. Companies offer both to give the employees options and also having both benefits the company.

c. Explain briefly the following terms used in Notes 2 and 6: grant date, exercise price, vesting period, expiration date, options/RSUs granted, options exercised, and options/RSUs forfeited or cancelled.

Grant Date: The grant date is usually the first day of the offering period. This is sometimes called the enrollment date.

Exercise Price: the price per share at which the owner of a traded option is entitled to buy or sell the underlying security.

Vesting Period: The vesting period is the time that an employee must wait in order to be able to exercise ESOs. Exercise of ESOs, where the employee notifies the company that he or she would like to buy the stock, allows the employee to buy the referenced shares at the strike price indicated in the ESO options agreement.

Expiration Date: The date in which the stock options or other incentives expire.

Option Granted: A stock option that is granted allows the employee the right to purchase a certain number of shares of the company's stock at a predetermined price.

RSUs Granted: are assigned a fair market value when they vest. Upon vesting, they are considered income, and a portion of the shares are withheld to pay income taxes. The employee receives the remaining shares and can sell them at any time.

Options Exercised: Exercise means to put into effect the right specified in a contract. In options trading, the option holder has the right, but not the obligation, to buy or sell the underlying instrument at a specified price on or before a specified date in the future.

Options/RSUs Forfeited or Cancelled: A forfeited share is a share in a company that the owner loses (forfeits) by failing to meet the purchase requirements.

d. Consider the information on the employee stock purchase plan (page 63 of Xilinx's annual report). Explain, in your own words, how this plan works. What incentives does this plan provide for Xilinx employees? How do these incentives differ from the incentives created under the employee stock option and RSU plans?

The plan offers a 24 month purchase right to company's common stock at the end of each six-month exercise period. However, there is a limit to only 15% of the employees' annual; there is maximum of $21 thousand in a calendar year. Almost 78% of employees that are eligible utilize the ESPP. In the beginning, the purchase price of the stock is 85% of the lower of the fair market value at the beginning of the 24-month offering period.

Under the Stock options plan, common stock is granted at 100% of the fair market value of the stock on the date of grant.

The fair values of stock options and stock purchase plan rights under the Company's equity incentive plans and ESPP were approximated using the Black-Scholes option pricing model. The expected life of options is based on the historical exercise activity as well as the expected disposition of all options outstanding. The fair values of the RSU award are calculated based on the market price of Xilinx common stock on the date of the grant, reduced by the present value of dividends expected to be paid on Xilinx common stock before vesting.

e. Note 2 describes Xilinx's accounting for stock-based compensation. Describe how Xilinx accounts for employee stock option activity? For RSU activity? For activity under the stock purchase plan?

The company has to measure the price of all employee equity awards that are supposed to be exercised based on the grant date fair value. The awards will vest for the unvested portion of awards that were granted at the date of adoption. Cash flows from excess tax benefits are to be classified as a part of cash flows from financing activities. The exercise price of employee stock options equals the market price of common stock on the date of grant. The employee stock purchase plan is in the computation of stock-based compensation expense. The company uses the straight-line attribution method to account for stock-based compensation costs over the requisite service period.

If exercised, cancellation or expiration of stock options, deferred tax assets for options with multiple vesting dates are eliminated for each vesting period on a first-in, first-out basis as if each award had a separate vesting period.

f. Consider Xilinx's 2013 statement of income, statement of cash flows and the table on page 59 of Xilinx's annual report that discloses information about stock-based compensation expense.

1)According to the table on page 59, what total expense (before income taxes) does Xilinx report for stock-based compensation in 2013?

The total expense for stock-based compensation in 2013 is $77,862 thousand.

2)Where on the statement of income does Xilinx include this expense? Explain.

Xilinx includes this expense in the cost of revenues, research and development, and sell, general, and administrative expenses. These are expenses that go into the stock-based compensation.

3)How does the 2013 expense affect the statement of cash flows? Describe where the amount of the expense appears in the statement of cash flows.

The expense is added back to the operation section of the statement of cash flows.

4)Explain in general terms, the income tax effects of Xilinx's 2013 stock-based compensation expense.

The income tax amounts show the use of the liability. Under the liability method, deferred tax assets and liabilities are recorded based on the expected future tax values of temporary differences between the carrying amounts of assets and liabilities for financial and income tax reporting purposes. The tax that is paid now is made into a deferred tax asset account. The stock options are deductible now for financial reporting, but not tax reporting.

5)Prepare the journal entry to record Xilinx's 2013 stock-based compensation expense. Your journal entry should include tax effects.

COGS	$6356 (in thousands)	
R+D Expenses	37,937	
SG+A Expense	33,569	
APIC-S/O		77,862
Deferred Tax Asset	22,137	
Income Tax Payable		22,137

I.Refer to the *Wall Street Journal* article titled "Last Gasp for Stock Options."

What trends does the article discuss in the use of employee stock options and restricted stock awards? Based on the article, which plan do companies find more attractive in recent years? Discuss the reasons for this view. Which plan do you think employees prefer? Why?

The trends of stock options becoming nonexistent are discussed in the article. It attributes their decline to shareholder demands, tax-law change and the financial crisis. RSUs have become more popular because of this. Companies have favored the RSUs in recent years because of that said above and also because they are easier to account for because they have less complexities. Employees probably prefer the RSUs because it is less risk; however, if the market is doing well, they would prefer the pay out from the stock options.

Referring to the tables in Xilinx's footnotes that detail stock option grant and RSU grant activity in recent years (pages 62 and 63 of Xilinx's annual report), is the trend in grants of these two forms of stock-based compensation consistent with the trends noted in the article? Cite the information used to support your answer.

Yes, when viewing the table on page 62 the number shares fell from 31,026(in thousands) in 2010 to 17,788 in 2012. On page 63, the RSUs follow an increasing trend from 3,652 in 2010 to 5,239 in 2012.

Case 6: Revenue Recoginition

PART I:

a. How does each step in the five-step revenue model apply to this transaction?

    a. Step 1: Identify the contract: The contract is between the customer and the bartender. The customer is asking for a cup of beer for $5.

    b. Step 2: Identify the performance obligation in the contract: The performance obligation is the giving of the beer to the customer.

    c. Step 3: Determine the transaction price: The transaction price for one cup of beer is $5.

    d. Step 4: Allocate the transaction price to the performance obligations in the contract: The price allocation of $5 goes to the one cup of beer.

    e. Step 5: Recognize Revenue when the entity satisfies a performance obligation: The performance obligation is met when the bartender hands the customer the cup of beer.

b. Debit: Cash $5

   Credit: Sales Revenue 5

PART II

a. How does each step in the five-step revenue model apply to this transaction?

    a. Step 1: Identify the contract: The contract is the exchange of the beer and the mug for $7.

    b. Step 2: Identify the performance obligation in the contract: The performance obligation is the giving of the mug and beer to the customer.

c. Step 3: Determine the transaction price: The transaction price for the bundle of the beer and mug is $7.

d. Step 4: Allocate the transaction price to the performance obligations in the contract: The transaction price is allocated by using relative sales value. $4.37 is allocated to the mug and $2.63 is added to the beer.

e. Step 5: Recognize Revenue when the entity satisfies a performance obligation: The performance obligation is met when the bartender hands the customer the mug of beer.

b. Debit: Cash 7

Credit: Sales Revenue-Mug 4.37

Credit: Sales Revenue-Beer 2.63

PART III

a. How does each step in the five-step revenue model to this transaction?

a. Step 1: Identify the contract: The contract is the exchange of the beer and coupon for the pretzels; however, the contract is open until the coupon is exchanged for pretzels.

b. Step 2: Identify the performance obligation: The performance is the giving of the beer and the coupon for the pretzels, and the eventual giving of the pretzels in exchange for the coupons.

c. Step 3: Determine the transaction price: The transaction price for the beer and the coupon is $7.

d. Step 4: Allocate the transaction price to the performance obligation: The price of the beer is $4.12 and the price of the pretzel/coupon is $2.88 using the relative sales value.

e. Step 5: Recognize Revenue when the entity satisfies a performance: The performance obligation is met over a period of time. The first part is recognized that day for the beer and the other part of the performance obligation is met when the coupons are exchanged for the pretzel.

b. Debit: Cash 7

   Credit: unearned sales revenue-pretzel/coupon 2.88

   Credit earned sales revenue-beer: 4.12

PART IV

a. How does each step in the five-step revenue model apply to this transaction?
   a. Step 1: Identify the contract: The contract is the giving of the coupons for the pretzels.
   b. Step 2: Identify the performance obligation: The performance is the giving of the coupon for the pretzels.
   c. Step 3: Determine the transaction price: The transaction price is the price of the coupon which was $2.00
   d. Step 4: Allocate the transaction price to the performance obligation: The allocation of the coupon worth $2.00 is for the pretzel.
   e. Step 5: Recognize revenue when the entity satisfies a performance: The revenue is recognized when the customer receives the pretzels for the coupon.
b. Debit: Unearned revenue Pretzel/coupon 2.88

   Credit: Sales Revenue Pretzel/coupon 2.88

Case 7: Zagg Inc

a. Describe what is meant by the term book income? Which number in ZAGG's statement of operation captures this notion for fiscal 2012? Describe how a company's book income differs from its taxable income.

BOOK INCOME: the income reported within the financial statements of the taxable entity. For example, taxable income normally is not aligned with the financial income (book income) reported within financial statements(Ventureline.com). In other words, the net income shown is the book income. The number on the statement of operations for fiscal 2012 is $14,505 (in thousands). The gap between book and tax income generally results from three categories of differences: temporary, permanent, and loss carryforwards/carrybacks(dummies.com).

b. In your own words, define the following terms:

i. Permanent tax differences: "results from items that enter into pretax financial income but never into taxable income or enter into taxable income but never into pretax financial income" (Kieso,Weygandt,Warfield). "An example is if a company reported pretax financial income of $200,000 in each of the years 2015, 2016, 2017. The company is subject to a 30 percent tax rate and has the following difference: Bio-Tech reports gross profit of $18,000 from an installment sale in 2015 for tax purposes over an 18-month period at a constant amount per month beginning January 1, 2016. It recognizes the entire amount for book purposes in 2015" (Kieso,Weygandt,Warfield).

ii. Temporary tax difference: "Temporary (or timing) differences between book income versus taxable income are due to items of revenue or expense that are recognized in one period for taxes, but in a different period for the books. Book recognition can come before or after tax recognition. These revenue and expense items cause a timing difference between the two incomes, but over the "long run", they cause no difference between the two incomes" (Investopedia.com). Two examples are: "(1) the calculation of depreciation expense by means of the straight-line method for books and by means of an accelerated method for taxes, and (2) the calculation of bad-debts expense by means of the allowance method for books and by means of the direct write-off method for taxes" (Investopedia.com).

iii. Statutory tax rate: "The statutory tax rate is the tax imposed by law (by "statute," hence the name). This is expressed as some percentage" (deanebarker.net). The statutory tax is a required tax that is imposed by federal regulation in other words.

iv. Effective tax rate: The actual percentage of the income that is paid in taxes.

c. Explain in general terms why a company reports deferred income taxes as part of their total income tax expense. Why don't companies simply report their current tax bill as their income tax expense?

The company reports the deferred income tax as a part of the income tax expense because it is a liability. If it was not included, their expenses would be deflated and their net income would be inflated. Companies do not report their current tax bill as their income tax expense because the total tax expense for a specific fiscal year may be different than the tax liability owed to the IRS as the company is postponing payment based on accounting rule differences(Investopedia.com).

d. Explain what deferred income tax assets and deferred income tax liabilities represent. Give an example of a situation that would give rise to each of these items on the balance sheet.

“A deferred income tax asset represents a situation where there has been an overpayment of taxes or prepaid taxes on its balance sheet. The taxes are eventually returned to the business in the form of tax relief, and the over-payment is, therefore, an asset for the company”(Investopedia.com). An example would be if the company prepaid their tax expense.

“A deferred income tax liability is an account on a company's balance sheet that is a result of temporary differences between the company's accounting and tax carrying values, the anticipated and enacted income tax rate, and estimated taxes payable for the current year. This liability may be realized during any given year, which makes the deferred status appropriate” (Investopedia.com). An example would be a company using depreciation like straight line or accelerated.

e. Explain what a deferred income tax valuation allowance is and when it should be recorded.

> A valuation allowance is a balance sheet line item that offsets all or a portion of the value of a company's deferred tax assets because the company doesn't expect it will be able to realize this value(wikiinvest.com). Therefore, it would be recorded only when the company believes that there is probability in not realizing all or a portion of the value.

f. Consider the information disclosed in Note 8 – Income Taxes to answer the following questions:

i. Using information in the first table in Note 8, show the journal entry that ZAGG recorded for the income tax provision in fiscal 2012?

Debit: Income Tax expense $9,393

Debit: Net deferred $8239

Credit: Income Tax Payable $17,680

ii. Using the information in the third table in Note 8, decompose the amount of "net deferred income taxes" recorded in income tax journal entry in part f. i. into its deferred income tax asset and deferred income tax liability components.

Debit: Income Tax Expense $9,393

Debit: Deferred Tax Asset $8,002

Debit: Deferred Tax Liability $291

Credit: Income Tax Payable $17,68

iii. The second table in Note 8 provides a reconciliation of income taxes computed using the federal statutory rate (35%) to income taxes computed using ZAGG's effective tax rate. Calculate ZAGG's 2012 effective tax rate using the information provided in their income statement. What accounts for the difference between the statutory rate and ZAGG's effective tax rate?

ETR=Tax expense/Pretax income= (9,393/23,898) =39.3%

iv. According to the third table in Note 8 – Income Taxes, ZAGG had a net deferred income tax asset balance of $13,508,000 at December 31, 2012. Explain where this amount appears on ZAGG's balance sheet.

The amounts appear separately on the balance sheet. The deferred income tax assets total is $6,912. The other portion is a separately listed assuming a non-current deferred income tax asset total of $6,596.

Case 8: Build-A-Bear

a. Why do companies lease assets rather than buy them?

The equipment has lower upfront cost, the expense to lease can be used as a tax deductible, and you are able to have the option of the newest equipment(smallbusiness.chron.com).

b. What is an operating lease? What is a capital lease? What is a direct-financing lease? What is a sales- type lease? (*Hint*: If your textbook does not cover these lease complexities, use your favorite Internet search engine to find definitions and examples.)

Operating lease: "An operating lease is the rental of an asset from a lessor, but not under terms that would classify it as a capital lease" (accountingtools.com). An operating lease lets the company omit the assets from the balance sheet.

Capital lease: "A capital lease is a lease in which the lessor only finances the lease, and all other rights of ownership transfer to the lessee, resulting in the recording of the asset as the lessee's property in its general ledger" (accountingtools.com). Because it is a capital lease, it can only record the interest as an expense.

Direct-financing lease: "A direct financing lease is a financing arrangement in which the lessor acquires assets and leases them to its customers, with the intent of generating revenue from the resulting interest payments. Under this arrangement, the lessor recognizes the gross investment in the lease and the related amount of unearned income" (accountingtools.com).

Sales-type lease:" A lease is classified as a sales-type lease by the lessor when the fair value of the leased property at the start of a lease varies from its carrying amount, it involves real estate, and there is a transfer of ownership to the lessee by the end of the lease term" (accountingtools.com). If the lease does not have real estate, it is classified as an operating lease.

c. Why do accountants distinguish between different types of leases?

Accountants distinguish between leases because, depending on the classification, the assets could affect the liability portion or the asset portion on the balance sheet.

d. Consider the following hypothetical lease for a Build-A-Bear Workshop retail location.

i. Will this lease be treated as an operating lease or a capital lease under current U.S. GAAP? Explain. It would be treated as an operating lease because there is no transfer. If there was a transfer of the land, it would be a capital lease. There is also no bargain purchase.

ii. Provide the journal entry that Build-A-Bear Workshop will record when it makes the first lease payment.

Debit: Rent expense 100,000

Credit: Cash 100,000

iii. Assume that a second lease is identical to this lease except that Build-A-Bear b Workshop is offered a "first year rent-free." That is, the company will make no cash payment at the end of year one, but will make payments of $125,000 at the end of each of years 2 through 5. Provide the journal entries that the company will make over the term of this lease.

Instead of paying unequal amounts, the cost should be an average cost of year 1 through 5 to get a uniform cost.

Debit: Rent Expense: 100,000

Debit: Deferred rent: 25,000

Credit: Cash: 125,000

e. Consider Build-A-Bear Workshop's operating lease payments and the information in Note 10, Commitments and Contingencies. Further information about their operating leases is reported in Note 1, Description of Business and Basis of Preparation (k) Deferred Rent.

What was the amount of rent expense on operating leases in fiscal 2009?

2009: 46.8 million

You add the rent expense and the contingents to get this number.

Where did that expense appear on the company's income statement?

It appeared in SG&A and store pre-opening.

f. Recent proposals by the Financial Accounting Standards Board and the International Accounting Standards Board would largely eliminate the option to use operating lease accounting. Most leases would be accounted for as capital leases (which are called "finance" leases under IFRS). The present value of the expected lease payments would be treated as a "right to use the leased asset." A corresponding capital lease obligation would be recorded, representing the liability incurred when the right-to-use asset was acquired. The asset would be amortized over a period not to exceed the lease term. The obligation would be accounted for as an interest-bearing obligation. Consider the future minimum lease payments made under the operating leases disclosed in Note 10, Commitments and Contingencies. Assume that all lease payments are made on the final day of each fiscal year. Also assume that payments made subsequent to 2014 are made evenly over three years.

Calculate the present value of the future minimum lease payments at January 2, 2010. Assume that the implicit interest rate in these leases is 7%.

Discount Rate	7%		
Period	PMT	PV Factor	PV of PMT
1	$50,651	0.9346	$47,337
2	47,107	0.8734	$41,145
3	42,345	0.8163	$34,566
4	35,469	0.7629	$27,059
5	31,319	0.7130	$22,330
6	25,229	0.6663	$16,811
7	25,229	0.6227	$15,711
8	25,229	0.5820	$14,684
		Total:	$219,644

i. Had Build-A-Bear Workshop entered into all of these leases on January 2, 2010 (the final day of fiscal 2009), what journal entry would the company have recorded if the leases were considered capital leases?

Debit: PPE 219,644

Credit: Lease Obligation 219,644

ii. What journal entries would the company record in fiscal 2010 for these leases, if they were considered capital leases? There are two: one to record interest expense and the lease payment and one to record amortization of the leased asset.

Debit: Lease Obligation 35,276

Debit: Interest Expense 15,375

Credit: Cash 50,651

Debit: Depreciation Expense 27,456

Credit: Accum. Depreciation 27,456

g. Under current U.S. GAAP, what incentives does Build-A-Bear Workshop, Inc.'s management have to structure its leases as operating leases? Comment on the effect of leasing on the quality of the company's financial reporting.

Operating leases do not increase the liabilities; therefore, the current ratio would be higher.

h. If Build-A-Bear had capitalized their operating leases as the FASB and IASB propose, key financial ratios would have been affected.

Refer to your solution to part *f*, above to compute the potential impact on the current ratio, debt-to-equity ratio (defined as total liabilities divided by stockholders' equity) and long-term debt-to-assets ratio (defined as long-term debt divided by total assets) at January 2, 2010. Is it true that the decision to capitalize leases will always yield weaker liquidity and solvency ratios?

	Original	Capitalized
Current Ratio	1.66	1.68
Debt to Equity	0.73	1.84
Debt to Assets	0.13	0.47

Capitalizing leases will not always yield weaker ratios based off of the ratios calculated.

Case 9: Rocky Mountain Chocolate Factory

Chart of Accounts

		Beg. Bal	1	2	3	4	5	6	7	8	9	10
	Cash and Cash equivalents	$1,253,947.00			$17,000,000.00	($8,200,000.00)	$4,100,000.00	($2,000,000.00)	($6,423,789.00)	$125,000.00	($498,832.00)	($2,403,458.00)
	Accounts receivable	4,229,733.00			5,000,000.00		(4,100,000.00)					
	Notes receivable, current	0.00										
	Inventories	4,064,611.00	7,500,000.00	6,000,000.00	(14,000,000.00)							
	Deferred income taxes	369,197.00										
Dr.	Other	224,378.00										
	Property and Equipment, Net	5,253,598.00									498,832.00	
	Notes Receivable, less current portion	124,452.00										
	Goodwill, net	1,046,944.00										
	Intangible assets, net	183,135.00										
	Other	91,057.00										
	Accounts payable	1,074,643.00	7,500,000.00			(8,200,000.00)						
	Accrued salaries and wages	423,789.00		6,000,000.00					(6,423,789.00)			
	Other accrued expenses	531,941.00						3,300,000.00				
	Dividend payable	598,986.00										3,709.00
	Deferred income	142,000.00								125,000.00		
Cr.	Deferred income taxes	827,700.00										
	Common Stock	179,696.00										
	Additional Paid-capital	7,311,280.00										
	Retained earnings	5,751,017.00										(2,407,167.00)
	Sales	0.00			22,000,000.00							
	Franchise and royalty fees	0.00										
	Cost of sales	0.00			14,000,000.00							
	Franchise costs	0.00										
	Sales & marketing	0.00						1,505,431.00				
Dr.	General and administrative	0.00						2,044,569.00				
	Retail operating	0.00						1,750,000.00				
	Depreciation and amortization	0.00										
	Interest income	0.00										
	Income Tax Expense	0.00										

Chart of Accounts (cont.)

		11	UTB	12	13	14	15	Pre-Closing TB	16	Post-Closing Balance	Actual Feb. 28,2010 F/S Fig.
Dr.	Cash and Cash equivalents	$790,224.00	$3,743,092.00					$3,743,092.00		$3,743,092.00	$3,743,092.00
	Accounts receivable	(702,207.00)	4,427,526.00					4,427,526.00		4,427,526.00	4,427,526.00
	Notes receivable, current	91,059.00	91,059.00					91,059.00		91,059.00	91,059.00
	Inventories	(66,328.00)	3,498,283.00	(216,836.00)				3,281,447.00		3,281,447.00	3,281,447.00
	Deferred income taxes	92,052.00	461,249.00					461,249.00		461,249.00	461,249.00
	Other	(4,215.00)	220,163.00					220,163.00		220,163.00	220,163.00
	Property and Equipment, Net	132,859.00	5,885,289.00		(698,580.00)			5,186,709.00		4,488,129.00	5,186,709.00
	Notes Receivable, less current portion	139,198.00	263,650.00					263,650.00		263,650.00	263,650.00
	Goodwill, net		1,046,944.00					1,046,944.00		1,046,944.00	1,046,944.00
	Intangible assets, net	(73,110.00)	110,025.00					110,025.00		110,025.00	110,025.00
	Other	(3,007.00)	88,050.00					88,050.00		88,050.00	88,050.00
Cr.	Accounts payable	503,189.00	877,832.00					877,832.00		877,832.00	877,832.00
	Accrued salaries and wages		0.00			646,156.00		646,156.00		646,156.00	646,156.00
	Other accrued expenses	(2,885,413.00)	946,528.00					946,528.00		946,528.00	946,528.00
	Dividend payable	(1.00)	602,694.00					602,694.00		602,694.00	602,694.00
	Deferred income	(46,062.00)	220,938.00					220,938.00		220,938.00	220,938.00
	Deferred income taxes	66,729.00	894,429.00					894,429.00		894,429.00	894,429.00
	Common Stock	1,112.00	180,808.00					180,808.00		180,808.00	180,808.00
	Additional Paid-capital	315,322.00	7,626,602.00					7,626,602.00		7,626,602.00	7,626,602.00
	Retained earnings		3,343,850.00					3,343,850.00	3,580,077.00	6,923,927.00	6,923,927.00
	Sales	944,017.00	22,944,017.00					22,944,017.00	(22,944,017.00)	0.00	22,944,017.00
	Franchise and royalty fees	5,492,531.00	5,492,531.00					5,492,531.00	(5,492,531.00)	0.00	5,492,531.00
Dr.	Cost of sales	693,786.00	14,693,786.00	216,836.00				14,910,622.00	(14,910,622.00)	0.00	14,910,622.00
	Franchise costs	1,499,477.00	1,499,477.00					1,499,477.00	(1,499,477.00)	0.00	1,499,477.00
	Sales & marketing		1,505,431.00					1,505,431.00	(1,505,431.00)	0.00	1,505,431.00
	General and administrative	(261,622.00)	1,782,947.00			639,200.00		2,422,147.00	(3,061,347.00)	0.00	2,422,147.00
	Retail operating		1,750,000.00			6,956.00		1,756,956.00	(1,763,912.00)	0.00	1,756,956.00
	Depreciation and amortization		0.00		698,580.00			698,580.00	(1,397,160.00)	0.00	698,580.00
	Interest income	(27,210.00)	(27,210.00)					(27,210.00)	27,210.00	0.00	(27,210.00)
	Income Tax Expense	2,090,468.00	2,090,468.00					2,090,468.00	(2,090,468.00)	0.00	2,090,468.00

Income Statement

Rocky Mountain Chocolate Factory, Inc. Income Statement For Year End Feb. 28, 2010	
Revenues and Sales	
Sales	$22,944,017
Franchise/Royalty Fees	5,492,531
Total Revenues	28,436,548
Cost and Expenses	
Cost of Sales	14,910,622.00
Franchse Costs	1,499,477.00
Sales/Marketing	1,505,431.00
General/Admin	2,422,147.00
Retail Operating	1,756,956.00
Deprec./Amortiziation	698,580.00
Total Costs and expenses	22,793,213.00
Operating Income	5,643,335.00
Interest Income	$27,210.00
Income Before Tax	5,670,545
Income Tax Expense	2,090,468.00
Net Income	3,580,077.00

Balance Sheet

Rocky Mountain Chocolate Factory, Inc. Balance Sheet For Year End Feb. 28, 2010	
Assets	
Current Assets	
Cash and Cash Equilvalents	3,743,092.00
Accounts Receivable	4,427,526.00
Notes Receivable, current	91,059.00
Inventories	3,281,447.00
Deferred Income Taxes	461,249.00
Other Current Assets	220,163.00
Total Current Assets	12,224,536.00
Longterm Assets	
Property and Equipment, net	5,186,709.00
Notes Receivable, less current portion	263,650.00
Goodwill, net	1,046,944.00
Intangible assets, net	110,025.00
Other Long Term Assets	88,050.00
Total Long Term Assets	6,695,378.00
Total Assets	18,919,914.00
Liabilities and Stockholders' Equity	
Current Liabilities	
Accounts Payable	877,832.00
Accrued Salaries and Wages	646,156.00
Other Accrued Expenses	946,528.00
Dividend Payable	602,694.00
Deferred Income	220,938.00
Deferred Income Taxes	894,429.00
Total Current Liabilities	4,188,577.00
Stockholder's Equity	
Common Stock	180,808.00
Additional Paid-In Capital	7,626,602.00
Retained Earnings	6,923,927.00
Total Stockholders' Equity	14,731,337.00
Total Liabilities and Stockholders' Equity	18,919,914.00

Statement of Retain Earnings

Rocky Mountain Chocolate Factory, Inc. Statement of Retained Earnings For Year End Feb. 28, 2010	
Retained Earnings, Feb 28, 2009	$5,751,017
Add: Net Income	3,580,077
Less: Dividends	(2,407,167.00)
Retained Earnigns, Feb 28, 2010	$6,923,927

Classification of Cash Flows

Cash Flow Classification Chart	
Purchase Inventory	Operating
Incur Factory Wages	Non Cash Operating
Sell Inventory	Cash Sales=Operating, Sales On Account= non cash operating, Cost of Sales=non cash operating
Pay for Inventory	Operating
Collect Receivables	Operating
Incur Sell/Gen Admin	Operating
Pay Wages	Operating
Receiving franchise fees	Operating
Purchase of Property, Plant, Equip.	Investing
Dividends Declared and Paid	Financing
All Other Transactions	N/A
Inventory Count Adjustment	Non Cash Operating
Record Depreciation	Non Cash Operating
Wages Accrual	Wage Accrual
Consultant's Report	N/A

Jouranl Entries

General Ledger		
Account	Dr.	Cr.
1) Raw Material	$7,500,000.00	
Accounts Payable		$7,500,000.00
2) Inventory	6,000,000.00	
Accrued Salaries/Wages		6,000,000.00
3) Cash	17,000,000.00	
Accounts Recievable	5,000,000.00	
Sales		22,000,000.00
Cost of Sales	14,000,000.00	
Inventory		14,000,000.00
4) Accounts Payable	8,200,000.00	
Cash		8,200,000.00
5) Cash	4,100,000.00	
Accounts Receivable		4,100,000.00
6) Sales/Marketing Exp.	1,505,431.00	
Gen./Admin. Exp.	2,044,569.00	
Retail Oper. Exp.	1,750,000.00	
Cash		2,000,000.00
Other Accrued Exp.		3,300,000.00
7) Accrued Salaries/Wages	6,423,789.00	
Cash		6,423,789.00
8) Cash	125,000.00	
Deferred Income		125,000.00
9) Property and Equipment	498,832.00	
Cash		498,832.00
10) Retained Earnings	2,407,167.00	
Cash		2,403,458.00
Dividends Payable		3,709.00
12) Cost of Sales	216,836.00	
Inventory		216,836.00
13) Depreciation and Amortization Expense	698,580.00	
Equipment and Property, net		698,580.00
14) General and Administrative Expenses	639,200.00	
Retail Operating Expenses	6,956.00	
Accrued Salaries/Wages		646,156.00

Journal Entries (cont.)

Closing Entries			
Sales		$22,944,017.00	
Franchise/Royalty Fees		5,492,531	
Interest Income		27,210	
	Cost of Sales		$14,910,622.00
	Franchise Costs		1,499,477
	Sell/Gen.Admin		2,422,147
	Sales/Marketing		1,505,431
	Retail Operating		1,756,956
	Dep/Amort		698,580
	Income Tax Expense		2,090,468
	Retained Earnings		3,580,077

Case 10: Income Statement Presentation

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Executive Summary

Totz is a registered company with the SEC and " has its year end on the Saturday closest to January 31st." The 2016, 2015, and 2014 fiscal years ended on January 30, 2016, January 31st, 2015, and January 2014, respectively. The company manufacturers and has retail of "high quality and stylish children's clothing." Totz' stores are very vibrant. In Totz' stores, there is also Doodlez, which is an art studio that was introduced in the third quarter of the 2015 fiscal year.

Analysis of Totz Income Statement Presentation

Net Sales

Totz had an increase of $12 million dollars from fiscal year 2015 to fiscal year 2016. The increase was aided by the addition of the services performed by Doodlez, which had $3.9 million revenue in fiscal 2015 and $11.2 million revenue in 2016. According to ASC 225-10-S99-2 in the FASB Codification, net sales is presented in the operating section of the multi-step income statement. The following is stated in the codification under ASC 225-10-S99-2:

> "(a) The purpose of this rule is to indicate the various line items which, if applicable, and except as otherwise permitted by the Commission, should appear on the face of the income statements filed for the persons to whom this article pertains (see § 210.4–01(a)).
>
> (b) If income is derived from more than one of the subcaptions described under § 210.5–03.1, each class which is not more than 10 percent of the sum of the items may be combined with another class. If these items are combined, related costs and expenses as described under § 210.5–03.2 shall be combined in the same manner.
>
> 1. Net sales and gross revenues. State separately:
>
>> (a) Net sales of tangible products (gross sales less discounts, returns and allowances),
>>
>> (b) operating revenues of public utilities or others;
>>
>> (c) income from rentals;
>>
>> (d) revenues from services; and
>>
>> (e) other revenues."

It should be noted in the footnotes or in a comparative income statement that the earnings from Doodlez was only from the third quarter the prior year.

Gross Profit

Totz had an increase of gross profit from $28 million in its 2015 fiscal year to $30.4 million in its 2016 fiscal year. The cost of sales included “expenses incurred to acquire and produce inventory for sale, such as product costs, freight-in and import costs, and direct labor costs for Doodlez' employees. Cost of sales excludes depreciation. In the cost of sales segment, there was an increase from $46.5 million to $56.1 million in the 2016 fiscal year. This was in most part due to the increase of the cost of Doodlez' services. The gross profit of the company is presented in the operation section of the multi step income statement. The ASU 225-10-S99-8 in the codification states the following about the exclusion of depreciation:

> “Facts: Company B excludes depreciation and depletion from cost of sales in its income statement.
>
> Question: How should this exclusion be disclosed?
>
> Interpretive Response: If cost of sales or operating expenses exclude charges for depreciation, depletion and amortization of property, plant and equipment, the description of the line item should read somewhat as follows: "Cost of goods sold (exclusive of items shown separately below)" or "Cost of goods sold (exclusive of depreciation shown separately below)." To avoid placing undue emphasis on "cash flow," depreciation, depletion and amortization should not be positioned in the income statement in a manner which results in reporting a figure for income before depreciation.”

The depreciation expense that was originally excluded from cost of sales must be noted in the cost of sales.

Section ASU 225-10-S99of the codification states the following about expenses:

2. Costs and expenses applicable to sales and revenues.

State separately the amount of

(a) cost of tangible goods sold,

(b) operating expenses of public utilities or others,

(c) expenses applicable to rental income,

(d) cost of services, and

(e) expenses applicable to other revenues.

Merchandising organizations, both wholesale and retail, may include occupancy and buying costs under caption 2(a). Amounts of costs and expenses incurred from transactions with related parties shall be disclosed as required under § 210.4–08(k).

The operating expenses from Totz and Doodlez both exceed ten percent and should be reported separately as cost of tangible goods and cost of services in the operating section under the cost of sales segment in the multi-step income statement.

Gain on Sale of Corporate Headquarters

Totz sold their original headquarters building and moved to a new building in Mountain View California. After selling the abandoned building, the company realized a gain of $1.7 million on the sale. This gain will be presented in the non operating section of the multi step income statement. In section 360-10-45-9, the following is stated:

“A long-lived asset (disposal group) to be sold shall be classified as held for sale in the period in which all of the following criteria are met:

a. Management, having the authority to approve the action, commits to a plan to sell the asset (disposal group).

b. The asset (disposal group) is available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets (disposal groups). (See Examples 5 through 7 [paragraphs 360-10-55-37 through 55-41], which illustrate when that criterion would be met).

c. An active program to locate a buyer and other actions required to complete the plan to sell the asset (disposal group) have been initiated.

d. The sale of the asset (disposal group) is probable, and transfer of the asset (disposal group) is expected to qualify for recognition as a completed sale, within one year, except as permitted by paragraph 360-10-45-11. (See Example 8 [paragraph 360-10-55-43], which illustrates when that criterion would be met). The term probable refers to a future sale that is likely to occur.

e. The asset (disposal group) is being actively marketed for sale at a price that is reasonable in relation to its current fair value. The price at which a long-lived asset (disposal group) is being marketed is indicative of whether the entity currently has the intent and ability to sell the asset (disposal group). A market price that is reasonable in relation to fair value indicates that the asset (disposal group) is available for immediate sale, whereas a market price in excess of fair value indicates that the asset (disposal group) is not available for immediate sale.

f. Actions required to complete the plan indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn."

The company should use this section of the codification as a reference because of the criteria that their sell meets.

Class Action Settlement

Totz realized that the natural fiber they were using from their suppliers was not natural. In the 2016 fiscal year, Totz settled a class action lawsuit related to the legal case against the supplier and received $2.7 million. The gain from this settlement will be in the non operating section of the multistep income statement. Section 225-20-45-16 states the following:

> "A material event or transaction that is unusual in nature or occurs infrequently but not both, and therefore does not meet both criteria for classification as an extraordinary item, shall be reported as a separate component of income from continuing operations. The nature and financial effects of each event or transaction shall be disclosed on the face of the income statement or, alternatively, in notes to financial statements. Gains or losses of a similar nature that are not individually material shall be aggregated. Such items shall not be reported on the face of the income statement net of income taxes or in any other manner that may imply that t they are extraordinary items. Similarly, the EPS effects of those items shall not be presented on the face of the income statement."

Although “extraordinary items” are seen as irrelevant now, this even constitutes as an infrequent event. The gain from the event should be “disclosed on the face of the income statement” or in a foot note. If this gain is not material it will be combined with other gains or losses.

Case 11: Financial Analysis of Glenwood Heating, Inc. and Ead's Heaters, Inc.

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Executive Summary

In the following financial analysis of Glenwood Heating, Inc. and Eads Heater, Inc., I have used several financial statements and ratios to come to the conclusion on which company to invest in. Both companies began operation in 20X1 and had an overall successful year as companies; however, the slight differences in success between the two allow for an easy decision to be made. Each company had the exact same transactions through Part A of the document; it was in the adjusting entries (Part B) of the companies where numbers began to change.

Throughout the analysis, there are financial statements and other data for each company. After analyzing the data and financial statements, I have decided to urge stakeholders to invest in Glenwood Heating, Inc. The ratios used and the analysis of the financial statements supports this decision. The significant difference in the two companies is the capital lease that Eads Heaters, Inc. entered into. This long-term decision greatly affected their financials and the decision to promote Glenwood Heating, Inc.

In the following document, please refer to the evaluations and analysis to view how and why the decision to choose Glenwood Heating, Inc. was made. There are several supporting financials, as mentioned above, and ratios that have been provided.

Evaluation of Glenwood Heating, Inc.

Glenwood Heating, Inc.'s financial statements show that the company has very little cash on hand. The company's income statement shows a net income of $92,742.00 with majority of expenses belonging to "Other Operating Expenses." Another area that Glenwood excels in is the "Total Stockholder's Equity" account with a balance of $229,742.00. An increase in stockholder's equity is not always a good sign; however, with Glenwood, its increased stockholder's equity is equated to the higher retained earnings and the company's growth. Glenwood's cash flow from operating activities shows a negative balance, which could signify a growing company or poor allocation of collected funds. More than half of the total of equity and liabilities come from liabilities at a total of $413,090.00 out of $642,632.00.

Evaluation of Eads Heaters, Inc.

Eads Heaters Inc.'s financial statements show that the company has cash balance of $7,835. The company's income statement shows a net income of $70,515 with the majority of expenses belonging to "Depreciation Expenses." Eads has a large amount of "Bad Debt Expense" totaling $4,970. Eads' cash flow from operating activities shows a small negative balance, which could signify a growing company or poor allocation of collected funds. Eads has a total of $703,765 in assets as of December 31, 20X1. More than half of the total of equity and liabilities come from liabilities at a total of $496,450.00 out of $703,765.00.

Analysis of Glenwood Heating, Inc. and Eads Heating, Inc.

Both companies that are being analyzed were founded in 20X1. After both companies had a successful year, I have prepared and analyzed several financials to analyze. In reviewing their financial statements, I have decided that Glenwood Heating, Inc. is the safest and most logical company in which to invest.

When comparing each company's income statement, it shows that Glenwood has a net income of $92,742 and Eads has a net income of $70,515. As you can see, Glenwood has over a $20,000 edge on Eads. With such a significant gap between the companies, it was an easy decision to select Glenwood when comparing the income statements.

When comparing the Statements of Changes in Stockholders' Equity, they indicated that Glenwood has a retained earnings total of $69,542 and total stockholders' equity of $252,742. Eads has a retained earnings total of $47,315 and a total stockholders' equity of $207,315. Again, Glenwood is the clear choice based off of these two totals.

Glenwood has a cash flow from investing total of -$500,000, and Eads has a total cash flow from investing of -$508,640. Using this information, it is shown that Eads prefers to invest more. Glenwood has an ending cash balance of $426, and Eads has an ending cash balance of $7,835. With such a difference in income, it is normal to be skeptical of the decision to choose Glenwood over Eads; however, in the following pages I will relay more information that influenced this decision.

Using the debt-to-asset ratio, I found that Glenwood has better solvency than Eads. This ratio measures the percentage of a company's total assets that is financed by debt. Although there is only a difference of .06, it is still a notable difference to take into account when deciding what company you wish to invest your money in.

Debt-to-Assets Ratio	
Glenwood, Inc.	Eads, Inc.
0.64	0.7
Debt-to-Assets Ratio=Total Liabilities/Total Assets	

Using the debt-to-equity ratio, I found that Glenwood has a lower ratio than Eads means that Glenwood has lower financial leverage and risk. When investing money, it is important to weigh your option when it comes to the leverage and risk of a company. Although high-risk companies can sometimes generate more returns, it is always safest to go with the company with low leverage and risk.

Debt-to-Equity	
Glenwood, Inc.	Eads, Inc.
1.8	2.39
Debt-to-Equity Ratio=Total Liabilities/Total Equity	

Using the information above, I weighed the options presented and made the clear choice to choose Glenwood Heating, Inc. All the information can be found on the supporting financial statements in the appendix.

Glenwood Heating, Inc. Appendix

Journal Entries

GENERAL LEDGER			
DATE	ACCT NAME	DEBIT	CREDIT
1/02/20X1	Cash	$160,000.00	
	C/S		$160,000.00
1/02/20X1	Cash	$400,000.00	
	N/P		$400,000.00
1/03/20X1	Land	$70,000.00	
	Building	$350,000.00	
	Cash		$420,000.00
1/05/20X1	Equipment	$80,000.00	
	Cash		$80,000.00
12/31/20X1	Inventory	$239,800.00	
	A/P		$239,800.00
12/31/20X1	A/R	$398,500.00	
	Sales		$398,500.00
12/31/20X1	Cash	$299,100.00	
	A/R		$299,100.00
12/31/20X1	A/P	$213,360.00	
	Cash		$213,360.00
9/30/20X1	N/P	$20,000.00	
	Interest Payable	$21,000.00	
	Cash		$41,000.00
12/31/20X1	Other oper. Exp.	$34,200.00	
	Cash		$34,200.00
12/01/20X1	Dividends	$23,200.00	
	Cash		$23,200.00
12/31/20X1	Interest Expense	$6,650.00	
	Interest Payble		$6,650.00
	TOTALS	$2,315,810.00	$2,315,810.00

ADJUSTING JOURNAL ENTRIES

ADJUSTING ENTRIES			
DATE	ACCT NAME	DEBIT	CREDIT
12/31/20X1	Bad Debt Expense	$994.00	
	Allow. For DoubAt. Acc.		$994.00
12/31/20X1	COGS	$177,000.00	
	Inventory		$177,000.00
12/31/20X1	Depreciation Expense	$10,000.00	
	Acc. Deprc.-Build.		$10,000.00
12/31/20X1	Depreciation Expense	$9,000.00	
	Acc. Deprc.-Equip.		$9,000.00
12/31/20X1	Rent Expense	$16,000.00	
	Cash		$16,000.00
	TOTALS	$212,994.00	$212,994.00

Chart of Accounts

Glenwood Heating, Inc.

Chart of Accounts

As of December 31, 20X1

Part A	Assets: Cash	A/R	Inventory	Land	Building	Equipment	Liabilities: A/P	N/P	I/P	Equity: C/S	R/E
No.1	$160,000.00									$160,000.00	
No.2	$400,000.00							$400,000.00			
No.3	-$420,000.00			$70,000.00	$350,000.00						
No.4	-$80,000.00					$80,000.00					
No.5			$239,800.00				$239,800.00				
No.6		$398,500.00									$398,500.00
No.7	$299,100.00	-$299,100.00									
No.8	-$213,360.00						-$213,360.00				
No.9	-$41,000.00							-$20,000.00			-$21,000.00
No.10	-$34,200.00										-$34,200.00
No.11	-$23,200.00										-$23,200.00
No.12											-$6,650.00
Balances	**$47,340.00**	$99,400.00	$239,800.00	$70,000.00	$350,000.00	$80,000.00	$26,440.00	$380,000.00	-$6,650.00	$160,000.00	$313,450.00

Part B

	Assets: Cash	A/R	ABD	Inventory	Land	Building	Equipment	Acc. Dep.
Part A Balances	$47,340.00	$99,400.00	$0.00	$239,800.00	$70,000.00	$350,000.00	$80,000.00	$0.00
Bad Debt			$994.00					
Cost of Goods Sold				-$177,000.00				
Depreciation								
Building								$10,000.00
Equipment								$9,000.00
Equipment								
Rental Payment	-$16,000.00							
Income Tax	-$30,914.00							
Balances	$426.00	$99,400.00	$994.00	$62,800.00	$70,000.00	$350,000.00	$80,000.00	$19,000.00

	Liabilities: A/P	N/P	I/P	Equity: C/S	R/E
Part A Balances	$26,440.00	$380,000.00	-$6,650.00	$160,000.00	$313,450.00
Bad Debt					-$994.00
Cost of Goods Sold					-$177,000.00
Depreciation					
Building					-$10,000.00
Equipment					-$9,000.00
Equipment					
Rental Payment					-$16,000.00
Income Tax					-$30,914.00
Balances	26400	$380,000.00	-$6,650.00	$160,000.00	$69,542.00

Trial Balance

Glenwood Heating, Inc. Trial Balance For Year End December 31, 20X1		
Asset Accounts		
Cash	$426.00	
Accounts Receievable	$99,400.00	
Allowance for Bad Debts		$994.00
Inventory	$62,800.00	
Land	$70,000.00	
Building	$350,000.00	
Accumulated Depreciation, Building		$10,000.00
Equipment	$80,000.00	
Accumulated Depreciation, Equipment		$9,000.00
Liability Accounts		
Accounts Payable		$26,440.00
Interest Payable		$6,650.00
Note Payable		$380,000.00
Equity Accounts		
Common Stock		$160,000.00
Dividends	$23,200.00	
Sales		$398,500.00
Cost of Goods Sold	$177,000.00	
Bad Debt Expense	$994.00	
Depreciation Expense	$19,000.00	
Interest Expense	$27,650.00	
Other Operating Expenses	$34,200.00	
Rent Expense	$16,000.00	
Provision for Income Taxes	$30,914.00	
TOTALS:	$991,584.00	$991,584.00

Income Statement

Glenwood Heating, Inc.		
Income Statement		
For year End December 31, 20X1		
Sales		$398,500.00
Cost of Goods Sold		-177,000.00
Gross Profit		$221,500.00
Operating Expenses		
Rent Expense	$16,000.00	
Depreciation Expense	$19,000.00	
Bad Debt Expense	$994	
Other Operating Expenses	$34,200.00	
Total Operating Expenses		-$70,194.00
Operating Income		$151,306.00
Non-Operating Income		
Interest Expense	$27,650.00	
Provision for Income Taxes	$30,914.00	
Total Non-Operating Income		-$58,564.00
Net Income		$92,742.00

Statement of Changes in Stockholders' Equity

Glenwood Heating, Inc.
Statement of Changes in Stockholders' Equity
For Year End December 31, 20X1

	Common Stock	Retained Earnings	Total Stockholders' Equity
Balances 1/1/20X1			
Issued Shares	$160,000.00		$160,000.00
Net Income		$92,742.00	$92,742.00
Dividends		-$23,200.00	-$23,200.00
	$160,000.00	$69,542.00	$252,742.00

Balance Sheet

Glenwood Heating, Inc.
Balance Sheet
As of December 31, 20X1

Assets		**Liabilities**	
Current Assets		Current Liabilities	
Cash	$426.00	Accounts Payable	$26,440.00
Net Accounts Recievable	$98,406.00	Interest Payable	$6,650.00
Inventory	$62,800.00	Note Payable	$380,000.00
Property, Plant, & Equipment		Total Liabilities	$413,090.00
Land	$70,000.00		
Building	$350,000.00	**Equity**	
Equipment	$80,000.00	Common stock	$160,000.00
Less Accumulated Depcreciation	-$19,000.00	Retained Earnings	$69,542.00
		Total Equity	$229,542.00
Total Assets	$642,632.00	**Total Liabilities and Equity**	$642,632.00

Statement of Cash Flow

Glenwood Heating, Inc.		
Statement of Cash Flows		
For Year End December 31, 20X		
Operating Activites		
Net Income		$92,742.00
Depreciation Expense	$19,000.00	
Accounts Receivable	-$99,400.00	
Allowance For Bad Debt	$994.00	
Inventory	-$62,800.00	
Accounts Payable	$26,440.00	
Interest Payable	$6,650.00	
Cash Flow from Operating		-$16,374.00
Investing Activities		
Building Purchase	-$350,000.00	
Land Purchase	-$70,000.00	
Equipment Purchase	-$80,000.00	
Cash Flow from Investing		-$500,000.00
Financing Activities		
Line of Credit	$380,000.00	
Sale of Common Stock	$160,000.00	
Dividends	-$23,200.00	
Cash Flow from Financing		$516,800.00
Beginning Cash Balance		$0.00
Net Cash Flow		$426.00
End Cash Balance		$426.00

Ead's Heaters, Inc. Appendix

Chart of Accounts

Eads Heaters, Inc.

Chart of Accounts

As of December 31, 20X1

Part A	Cash	A/R	Inventory	Land	Building	Equipment	A/P	N/P	I/P	C/S	R/E
	Assets						**Liabilities**			**Equity**	
No.1	$160,000.00									$160,000.00	
No.2	$400,000.00							$400,000.00			
No.3	-$420,000.00			$70,000.00	$350,000.00						
No.4	-$80,000.00					$80,000.00					
No.5			$239,800.00				$239,800.00				
No.6		$398,500.00									$398,500.00
No.7	$299,100.00	-$299,100.00									
No.8	-$213,360.00						-$213,360.00				
No.9	-$41,000.00							-$20,000.00			-$21,000.00
No.10	-$34,200.00										-$34,200.00
No.11	-$23,200.00										-$23,200.00
No.12											-$6,650.00
Balances	$47,340.00	$99,400.00	$239,800.00	$70,000.00	$350,000.00	$80,000.00	$26,440.00	$380,000.00	-$6,650.00	$160,000.00	$313,450.00

Part B	Cash	A/R	ABD	Inventory	Land	Building	Equipment	Acc. Dep.
	Assets							
Part A Balances	$47,340.00	$99,400.00	$0.00	$239,800.00	$70,000.00	$350,000.00	$80,000.00	$0.00
(1) Bad Debt			$4,970.00					
(2) Cost of Goods Sold				-$188,800.00				
(3) Depreciation								
Building								$10,000.00
Equipment								$20,000.00
(4)Equipment								
Lease								
Lease Payment	-$16,000.00							
Depreciation								$11,500.00
Income Tax	-$23,505.00							
Balances	$7,835.00	99,400	4970	$51,000.00	$70,000.00	$350,000.00	$80,000.00	$115,000.00

	A/P	N/P	I/P	C/S	R/E
	Liabilities			**Equity**	
Part A Balances	$26,440.00	$380,000.00	-$6,650.00	$160,000.00	$313,450.00
(1) Bad Debt					-$4,970.00
(2) Cost of Goods Sold					-$188,800.00
(3) Depreciation					
Building					-$10,000.00
Equipment					-$20,000.00
(4) Equipment					
Lease					
Lease Payment					-$7,360.00
Depreciation					-$11,500.00
(5) Income Tax					-$23,505.00
Balances	$26,440.00	$380,000.00	-$6,650.00	$160,000.00	$47,315.00

Trial Balance

Eads Heater, Inc.		
Trial Balance		
For Year End December 31, 20X1		
Asset Accounts		
Cash	$7,835.00	
Accounts Receievable	$99,400.00	
Allowance for Bad Debts		$4,970.00
Inventory	$51,000.00	
Land	$70,000.00	
Building	$350,000.00	
Accumulated Depreciation, Building		$10,000.00
Equipment	$80,000.00	
Accumulated Depreciation, Equipment		$20,000.00
Leased Equipment	$92,000.00	
Accumulated Decpreciation, Leased Equipment		$11,500.00
Liability Accounts		
Accounts Payable		$26,440.00
Interst Payable		$6,650.00
Note Payable		$380,000.00
Lease Payable		$83,360.00
Equity Accounts		
Common Stock		$160,000.00
Retained Earnings		
Dividends	$23,200.00	
Sales		$398,500.00
Cost of Goods Sold	$188,800.00	
Bad Debt Expense	$4,970.00	
Depreciation Expense	$41,500.00	
Interest Expense	$35,010.00	
Other Operating Expenses	$34,200.00	
Rent Expense		
Provision for Income Taxes	$23,505.00	
TOTALS:	$1,101,420.00	$1,101,420.00

Income Statement

Eads Heater, Inc.
Income Statement
For Year Ended December 31, 20X1

Sales		$398,500.00
Cost of Goods Sold		-$188,800.00
Gross Profit		$209,700.00
Operating Expenses		
Rent Expense		
Depreciation Expense	$41,500.00	
Bad Debt Expense	$4,970.00	
Other Operating Expenses	$34,200.00	
Total Operating Expenses		-$80,670.00
Operating Income		$129,030.00
Non-Operating or Other		
Intereset Expense	$35,010.00	
Provision for Income Taxes	$23,505.00	
Total Non-Operating		-$58,515.00
Net Income		$70,515.00

Statement of Changes in Stockholders' Equity

Eads Heater, Inc.
Statement of Changes in Stockholders' Equity
For Year Ended December 31, 20X1

	Common Stock	Retained Earnings	Total Stockholders' Equity
Balances 1/1/20X1	-	-	-
Issued Shares	$160,000.00		$160,000.00
Net Income		$70,515.00	$70,515.00
Dividends		-$23,200.00	-$23,200.00
Balances 12/31/20X1	$160,000.00	$47,315.00	$207,315.00

Balance Sheet

Eads Heater, Inc.
Balance Sheet
As of December 31, 20X1

Assets		**Liabilities**	
Current Assets		Current Liabilities	
Cash	$7,835.00	Accounts Payable	$26,440.00
Net Accounts Receivable	$94,430.00	Interest Payable	$6,650.00
Inventory	$51,000.00	Longterm Liabilities	
Property, Plant, & Equipment		Notes Payable	$380,000.00
Land	$70,000.00	Lease Payable	$83,360.00
Building	$350,000.00	Total Liabilities	$496,450.00
Equipment	$80,000.00		
Leased Equipment	$92,000.00	Equity	
Less Accumulated Depreciation	-$41,500.00	Common Stock	$160,000.00
		Retained Earnings	$47,315.00
		Total Equity	$207,315.00
Total Assets	$703,765.00	**Total Liabillities and Equity**	$703,765.00

Statement of Cash Flows

Eads Heater, Inc.
Statement of Cash Flows
For Year End December 31, 20X

Operating Activites		
Net Income		$70,515.00
Depreciation Expense	$41,500.00	
Accounts Receivable	-$99,400.00	
Allowance For Bad Debt	$4,970.00	
Inventory	-$51,000.00	
Accounts Payable	$26,440.00	
Interest Payable	$6,650.00	
Cash Flow from Operating		-$325.00
Investing Activities		
Building Purchase	-$350,000.00	
Land Purchase	-$70,000.00	
Capital Lease Payment	-$8,640.00	
Equipment Purchase	-$80,000.00	
Cash Flow from Investing		-$508,640.00
Financing Activities		
Line of Credit	$380,000.00	
Sale of Common Stock	$160,000.00	
Dividends	-$23,200.00	
Cash Flow from Financing		$516,800.00
Beginning Cash Balance		$0.00
Net Cash Flow		$7,835.00
End Cash Balance		$7,835.00

Calculations and Schedules

Scheudle of COGS		
Quantity	CPU	Total Cost
40	$1,000.00	$40,000.00
60	$1,100.00	$66,000.00
20	$1,150.00	$23,000.00
40	$1,200.00	$48,000.00
	$4,450.00	$177,000.00

Schedule	Quantity	Cost/Unit	Total Cost
Jan	40	1000	40000
Mar	60	1100	66000
Jun	20	1150	23000
Sep	62	1200	74400
Oct	28	1300	36400
			239800

Schedule	Quantity	Cost/Unit	Total Cost
Jan	40	1000	40000
Mar	60	1100	66000
Jun	20	1150	23000
Sep	62	1200	74400
Oct	28	1300	36400
			239800